Ontario Tax Studies 14

Reduction of Tax Burdens Through Tax Credits: Ontario's Experience

Staff Paper

Ministry of Treasury, Economics and
Intergovernmental Affairs
Taxation and Fiscal Policy Branch

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Ontario Proposals For Tax Reform In Canada

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Preface

In 1972, the Province of Ontario introduced The Ontario Property Tax Credit Plan. Ontario was the first jurisdiction in North America to offer a universal tax relief program based on ability-to-pay as determined by taxable income under the personal income tax. While other jurisdictions had used tax credit schemes to offset property tax burdens, the benefits were, without exception, confined to the aged. More often than not, the credits were complex and highly restrictive.

Today, three other provinces in Canada are operating tax credit programs based on ability-to-pay. In total, seven provinces have introduced either tax credits or grant-type schemes to reduce the burden of taxes. Of the seven provinces, however, only Ontario and Manitoba operate comprehensive refundable tax credit schemes, which extend relief from the burden of other forms of taxation, in addition to property taxation.

Since its inception in 1972 as solely a property tax relief mechanism, the Ontario Tax Credit System has been substantially expanded by adding to the original property tax credit a sales tax credit and a credit for senior citizens. Its funding has also been substantially enriched, and formula changes have been introduced to ensure that the bulk of benefits flow to those with low incomes.

This study reviews the development, growth and operation of the Ontario tax credits. The analysis is based upon income tax data provided by the federal government to all provinces who have a Tax Collection Agreement with Ottawa. It was performed by means of sophisticated computer simulation techniques. The study was prepared by Tom Sweeting, Don Black and Harry Newton, with the assistance of Sam Chan.

D. M. Allan
Executive Director
Fiscal Policy Division

B. Jones
Director
Taxation and Fiscal
Policy Branch.

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Introduction

The pervasive impact of taxation on economic activity was a source of growing concern to both the general public and government in Canada in the early 1960's. Out of this concern emerged two separate committees, one federal and one Provincial, appointed to examine the taxation of individuals and businesses in Canada, and Ontario, and to present proposals for tax reform.

The federal committee, the Royal Commission on Taxation, focused its attention on the burdens and inequities of all taxes under federal jurisdiction.[1] The Provincial contribution to the debate was the Ontario Committee on Taxation, informally known as the Smith Committee. The Smith Committee spent three years studying the spectrum of provincial-municipal taxation as it impacts upon the individual and reported its findings to the Ontario Legislature in August, 1967.[2] The Ontario Legislature promptly appointed a Select Committee of the Legislature to study the Smith proposals and make recommendations to the Government of Ontario. By the fall of 1968, the Select Committee had completed this task.[3] In its next budget, the Government responded to both the Smith and Select Committee reports, proposing that taxation at all levels of government should undergo comprehensive reform.[4]

By 1970, it was evident that the federal government was not planning any comprehensive tax reform, focusing most of its energies on the reform of the personal income tax.[5] Ontario objected strongly to this partial approach, favouring instead an extensive overhaul of federal-provincial-municipal taxation. Integration of taxation was necessary and this could begin, Ontario believed, with the introduction of selective tax credits designed to offset the burden of the more regressive taxes.[6]

The federal government rejected the philosophy of tax credits, citing compliance and administrative complexity as major drawbacks to the credit principle. However, Ontario continued to advocate the introduction of selective income tax credits as a necessary part of reform, and, after three years of discussion, Ottawa agreed in late 1971 to administer an *Ontario* tax credit plan through the income tax system. The Ontario Property Tax Credit Plan was introduced for the following taxation year.

Chapter 1 of this study looks at the tax credit system in general, explaining the formula and its operation within the economic environment. Chapter 2 presents detailed information on the system's performance since 1972. The final chapter, Chapter 3, examines the place of tax credits in the tax reform debate.

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[1] *Report of the Royal Commission on Taxation* (Ottawa: Queen's Printer, 1966).

[2] *Report of the Ontario Committee on Taxation* (Toronto: Queen's Printer, 1967).

[3] *Taxation in Ontario: A Program for Reform, The Report of the Select Committee of the Legislature on The Report of the Ontario Committee on Taxation* (Toronto: Queen's Printer, 1968).

[4] Hon. Charles MacNaughton, "The Reform of Taxation and Government Structure in Ontario," *Ontario Budget 1969* (Toronto: Department of Treasury and Economics, 1969).

[5] Hon. E. J. Benson, *Proposals for Tax Reform* (Ottawa: Queen's Printer, 1969).

[6] Hon. Charles MacNaughton, *op. cit.* p. 56.

I An Overview of the Ontario Tax Credit System

In its first five years of operation, the Ontario Tax Credit System has delivered $1.7 billion in tax relief. Almost 3 million people a year enjoy its benefits. In its first year, the Ontario property tax credit plan delivered $180 million in credits to 2.3 million taxfilers. In the following year, credit payments increased by 67 per cent to almost $300 million, while the number of recipients increased by 22 per cent. A substantial increase in credit payments again occurred in 1974 as benefits rose to $385 million, but the number of credit recipients rose more slowly than in 1973. Benefit payments showed more moderate growth over the next two years, but, by 1976, payments under the scheme had reached $422 million, with over 60 per cent of all taxfilers receiving credits. The average tax credit had increased to $143 in 1976 from $77 in 1972. These performance trends are shown in Table I-1.

Major Performance Trends: Table I-1
The Ontario Tax Credit System, 1972-1975

	1972	1973	1974	1975	1976
No. of recipients (000)	2,329	2,843	2,898	2,995	2,954
No. of taxfilers (000)	4,174	4,427	4,662	4,755	4,906
Total credits ($ million)	180	296	385	404	422
Average credit ($)	77	104	133	135	143

Source: Ontario Treasury analysis of personal income tax data.

Property Tax Relief in Ontario

The property tax in Ontario was first subjected to intensive scrutiny by the Ontario Committee on Taxation. The Smith Committee recommended that the Province adopt "a flat exemption that would reduce the taxable assessment of every self-contained dwelling unit."[7] This suggestion was based on the fact that the property tax is levied without regard to ability-to-pay. The Province responded by implementing in 1968 the "Basic Shelter Exemption" grant program, under The Residential Property Tax Reduction Act.

In 1970, the Province introduced another grant program designed to provide additional interim relief from property taxation for needy pensioners. This relief was provided in the form of grants of $50 per single person and $100 per couple. To ensure that only those most in need received support, eligibility was limited to persons receiving the federal Guaranteed Income Supplement to the Old Age Security Program.

[7] *The Report of the Ontario Committee on Taxation, op. cit.* Volume II, p. 90.

It was recognized that while the Basic Shelter Exemption was delivered in horizontally equal amounts with respect to property taxes within a municipality, and while it adjusted annually to changes in property tax levels, it was incapable of achieving any improvement in the vertical equity of the property tax. Similarly, while the pensioner grant substantially lessened property tax burdens, its payment criterion was not based on property tax burdens and only loosely on income. Consequently, at the earliest opportunity, Ontario replaced these temporary programs with a more equitable and progressive system.

In the 1972 Ontario Budget, the Treasurer of Ontario, the Honourable W. Darcy McKeough, announced the introduction of a universal property tax credit plan financed by Ontario for the benefit of Ontario taxpayers.[8] Unlike the basic shelter grants that the credit plan replaced, the property tax credit was tied directly to ability-to-pay as determined through the personal income tax system. The property tax credit was envisioned as the first step in a more comprehensive policy of providing tax relief for Ontario residents. The Treasurer stated:

> "Once the tax credit plan has been in operation for a year, . . . we hope to be in a position to replace these special [grant] programs by enriching and modifying the general property tax credit formula. We are also exploring the possibility of extending our tax credit approach to take account of other provincial taxes, such as the retail sales tax and health premiums."[9]

Evolution of the Tax Credit Structure

The 1972 credit structure had a relatively straightforward goal—to reduce the burden of property taxation in a progressive fashion. It achieved this goal simply and efficiently. The structure has since been expanded and modified considerably in response to changing economic conditions and new priorities.

The original credit was designed to incorporate two variables—occupancy cost and taxable income. Occupancy cost was based upon property tax paid or 20 per cent of rent—the latter figure being a proxy for the property tax component in rent.

The structure ensured that the higher the occupancy cost the greater the amount of credit, thus offering more relief to those taxfilers who face a large property tax burden. At the same time, benefits declined as taxable income increased, thus concentrating the greatest benefits to low-income taxfilers. The credit thereby achieved vertical and horizontal equity. In addition, the system was sensitive to family size, since taxable income is affected by the number of dependants.

For 1972, the determination of an individual's property tax credit was:

$90 + 10% of occupancy cost—1% of taxable income.

For those individuals who incurred property taxes of less than $90, or annual rent of less than $450, the entitlement equalled actual property tax, or 20 per cent of rent, minus 1 per cent of taxable income. The maximum credit was limited to $250

This particular formula was chosen for two reasons. It delivered approximately the same dollar benefits to an average middle income family as did the Basic Shelter Exemption,

[8]See, The Hon. W. D. McKeough, *Ontario Budget 1972* (Toronto: Ministry of Treasury, Economics and Intergovernmental Affairs, 1972).
[9]*Ibid.*, Page 13.

and the cost of the credit scheme, at $180 million, was reasonably close to what the previous grant program would have cost.

In 1973, the credit system was enriched to include a sales tax credit. Two considerations prompted this development. First, the credit system quickly proved to be an efficient and equitable mechanism for increasing progressivity of the tax system. Initial results favoured extending the reform program as outlined in previous Government papers.[10] Second, the Province's retail sales tax was increased in 1973 from 5 per cent to 7 per cent. This tax was recognized as a relatively less progressive levy and, even with exemptions for food and other essential items, the increase would bear proportionately more on low-income persons with large families. Consequently, the progressivity of the 1972 tax credit formula, which was already sensitive to low-income family circumstances, was enhanced by the introduction of a proxy for sales tax paid to help offset the increased sales tax burden. The sales tax credit introduced was 1 per cent of personal exemptions, a proxy that directly recognizes family circumstances and age.

Also in 1973, the Province introduced a special flat credit of $100 for Ontarians aged 65 and over. This credit served as additional recognition of the special circumstances of pensioners. The $100 supplementary grants to pensioners receiving the federal Guaranteed Income Supplement (GIS), which had been introduced by the Province as a short-run measure in 1970, were consequently discontinued. By incorporating a $100 pensioner credit into the Ontario Tax Credit System, low-income pensioners still received a full $100, while middle and upper-income pensioners received a smaller amount based upon their ability-to-pay as determined by taxable income.

For 1973, the formula became:

$90 + 10% of occupancy cost + 1% of personal exemptions + $100 pensioner credit — 1% of taxable income.

The sales tax credit and the pensioner credit could both be claimed whether or not occupancy cost was incurred. Anyone could claim a sales tax credit provided they were not claimed as a dependant on another person's tax return. The pensioner credit was restricted to one per married couple, with the spouse with the higher taxable income required to claim the credit. The maximum credit allowed was increased to $400.

Additional modifications followed in 1974. In recognition of growing pressures on the disposable income of low-income persons, total relief was increased, while credit benefits were concentrated more in the low-income ranges. The basic $90 property tax credit was doubled to $180, while the taxable income offset was doubled to 2 per cent. In addition, the pensioner credit was increased to $110. The net effect was to increase benefits substantially for taxfilers with occupancy cost and with less than $9,000 taxable income. But at the same time, the increase in the offset rate served to reduce benefits to those taxfilers without occupancy cost. The structure in 1974 was:

$180 + 10% occupancy cost + 1% of personal exemptions + $110 pensioner credit — 2% of taxable income.

Finally, the maximum credit was raised to $500 in order to deliver greater benefits to low-income persons with large families and high property tax payments.

For 1975 and 1976, the formula remained unchanged. Table I-2 summarizes the evolution of the Ontario Tax Credit System over the first five years of its operation.

[10]Hon. Charles MacNaughton, *op. cit.*; and Hon. W. D. McKeough, *op. cit.*

The Ontario Tax Credit System, 1972-1976						Table I-2
Year	Basic Property Tax + Credit	Additional Property Tax + Credit	Sales Tax + Credit	Pensioner − Credit	Taxable Income Offset	Maximum
1972	A)[1] $90	10% of occupancy cost	—	—	1%	$250
	B)[2] occupancy cost	0	—	—	1%	
1973	lesser of occupancy cost or $90	10% of occupancy cost	1% of personal exemptions	$100	1%	$400
1974 1975 1976	lesser of occupancy cost or $180	10% of occupancy cost	1% of personal exemptions	$110	2%	$500

[1]Formula applied if occupancy cost equal to $90 or more.
[2]Formula applied if occupancy cost less than $90.

In terms of a representative family in the province, the value of the tax credit system over the period is shown in Table I-3. All income levels experienced an increase in credit entitlement, while the system continued to deliver the greatest relief to low-income filers.[11]

Impact of the Ontario Tax Credit System on a Representative Family,[1] 1972-1976 — Table I-3
(dollars)

Gross Income	Credit Entitlement[2] 1972	1973	1974	1975	1976
5,000	128	166	253	272	277
7,500	104	141	205	216	231
10,000	79	116	155	167	182
12,000	59	96	115	127	142
15,000	29	66	55	67	82
20,000	—	16	—	—	—
25,000	—	—	—	—	—

[1]Assumes family of four with one wage earner. Only personal exemptions plus the employment expense deduction, the standard $100 deduction and UIC and CPP deductions are included.
[2]Property tax burden of $500 is assumed.
Note: Gross income is employment income only. Family Allowances are excluded for purposes of comparison.

Additional Factors Influencing Tax Credit Relief

Since the credit formula is linked to certain key variables, the amount of relief and its delivery are influenced by the behaviour of economic and demographic factors. The system was designed with precisely this in mind, so that relief would be responsive to changing economic conditions.

[11]The values in Table I-3 reflect the effects of indexing the tax system and the introduction of the Ontario tax reduction scheme, as well as changes to the credit formula. These effects can lead to increases in entitlement without any change in the formula and are discussed in greater detail in following sections.

The principal determinant influencing the performance of the credit system is property taxation in Ontario. The linkage is direct; increases in property taxation lead to increases in occupancy cost and the 10 per cent occupancy cost apportionment automatically increases the amount of property tax credit. At the same time, property taxation, although levied by local government, is also influenced by the policies of the Government of Ontario. The Province, over the period, undertook considerable commitments to local governments to allow them greater flexibility and to moderate pressures on the property tax. One policy introduced by the Province—the Edmonton Commitment—was of particular importance.[12] By this policy, the Province guaranteed that funds transferred to local government would grow at the same rate as total Provincial budgetary revenue. This, and other such programs, had a definite effect on the level of property taxation in Ontario over the period. Property taxation increased by about 17 per cent from 1972 to 1974, compared to a 20 per cent increase in the CPI and a 22 per cent increase in local spending. The 1974 level of taxation represented only 38 per cent of local government expenditures, compared to 41 per cent in 1972. This behaviour fed back into the tax credit system, translating into very modest growth pressure on occupancy cost. For 1975 and 1976, however, the Province felt that spending increases of local government could no longer be as fully financed by Provincial revenue. As a result, the property tax increased sharply and this was reflected in increased occupancy cost. This occupancy cost growth was one of the major determinants of the $20 million increase in tax credit payments in 1975 and the $17 million increase in 1976. Table I-4 summarizes the growth of grant support for local government over the period, the level of property taxation, and the behaviour of occupancy cost.

Sources of Local Government Revenue and Their Impact on Occupancy Cost — Table I-4

	1972	1973	1974	1975	1976
Ontario Basic Financial Transfers to Local Governments and Agencies ($ million)	1,781	2,002	2,278	2,865	3,037
Property Tax in Ontario ($ million)	1,727	1,792	1,982	2,353	2,768
Property Taxation of Principal Residences[1] ($million)	959	979	1,075	1,261	1,501
Average Occupancy Cost Claimed for Tax Credit Purposes[2] (dollars)					
— Homeowners	426	429	434	486	n.a.
— Renters	248	256	280	311	n.a.
— All	350	351	359	399	439

[1]Ontario Treasury Estimates.
[2]Based upon only those filers claiming a property tax credit and consequently is not representative of the entire taxfiling population.
n.a. = not available.
Source: 1975 Ontario Budget; 1976 Ontario Budget; Municipal Financial Information, 1972-1976; and Ontario Treasury analysis of personal income tax data.

A second important influence on the delivery of benefits by the credit system is the growth in income and its treatment under the Income Tax Act. Growth in income tends to raise taxable income and thereby reduce credit entitlement. The period 1972 to 1976 saw extremely rapid growth in personal income reported for tax purposes, particularly in the

[12]Hon. John White, *Ontario Budget 1974* (Toronto: Ministry of Treasury, Economics and Intergovernmental Affairs, 1974) p. 19.

latter part of the period.[13] However, to the degree that new income tax measures operate to retard growth in taxable income, relative to gross income, the number of credit recipients and credit payments will be higher than had such changes not been introduced.

Such was the case from 1972 to 1976. As a result of changes and innovations to the Income Tax Act, taxable income exhibited considerably slower growth than gross income.[14] As well, to the extent that these measures impacted upon the personal exemptions the value of the sales tax credit payments increased. The strong growth in income, the considerable modification of personal exemptions, and the level of taxable income from 1972 to 1976 are shown in Table I-5.

Features of The Income Tax System, 1972-1976 — Table I-5
(dollars)

	1972	1973	1974	1975	1976
Average Gross Income	6,692	7,286	8,293	9,242	10,178
Average Taxable Income	4,142	4,599	5,227	5,805	6,392
Personal Exemptions					
— Single	1,500	1,600	1,706	1,878	2,090
— Spouse	1,350	1,400	1,492	1,642	1,830
— Children under 16	300	300	320	352	390
— Dependants (excluding children under 16)	550	550	586	646	720

Source: Ontario Treasury analysis of personal income tax data.

Demographic Influences on the Ontario Tax Credit System — Table I-6
(per cent)

	1973/72	1974/73	1975/74	1976/75
Population growth in Ontario	1.5	2.0	1.6	1.1
Labour force growth	3.9	4.6	3.8	1.9
Taxfiler growth in Ontario	6.1	5.3	2.0	3.1

Source: "Canadian Statistical Review", Statistics Canada Cat. 11-003; "Revised Labour Force Historical Series", Statistics Canada, Special Tabulations, and Ontario Treasury analysis of income tax data.

[13] See, Ontario Tax Study 12, *Major Growth Characteristics of The Personal Income Tax in Ontario, 1972-74* (Toronto: Ministry of Treasury, Economics and Intergovernmental Affairs, 1976). The study looks in detail at the growth in income for the first three years of this period.

[14] The major changes to the income tax from 1973-1976 were:

1973 — personal exemptions increased by $100 for single and $50 for spouse.
1974 — indexing increased personal exemptions by 6.6%.
— $1,000 interest income deduction
— $1,000 deduction for contributions to a RHOSP.
1975 — indexing increased personal exemptions by a further 10.1%
— dividend income added to the $1,000 interest deduction
— up to $1,000 of private pension income deductible for tax purposes.
1976 — further indexing of 11.3%
— registered retirement savings plan deduction limits increased by $1,000 and $1,500, whichever is applicable
— child care deduction limits increased from $500 to $1,000 per child and from $2,000 to $4,000 per return.

The third major influence on credit payments is population growth and growth in the labour force. As new labour force entrants assume active roles in the economy, the number of persons who file tax returns and who become eligible for credits increases. More subtle effects relate to the impact of population growth on tax exemptions and taxable income, and to the impact of a changing composition of the population according to age. The major demographic influences over the period are documented in Table I-6. The positive nature of these factors over the period all impacted on the system to generate a steady increase in credit payments.

Impact of Tax Credits on Effective Tax Rates

Looking at the general impact of the credits on income tax payable, implementation of the Ontario Tax Credit System has considerably improved the progressivity of the tax system in Ontario. The overall effective personal income tax rate was lowered in every year, with the bulk of the reduction benefitting low-income taxfilers. Table I-7 illustrates the impact of the tax credit system on effective tax rates.

Impact of Tax Credits on Effective Ontario Personal Income Tax Rates and the Distribution of Tax Paid (per cent) — Table I-7

	1972	1973	1974	1975	1976
Average effective tax rates					
— before credits	4.0	4.3	4.2	4.2	4.2
— after credits	3.4	3.3	3.2	3.2	3.3
Share of total personal income tax paid by filers reporting less than $10,000 income					
— before credits	38.9	32.0	23.3	17.0	12.9
— after credits	34.3	26.5	16.5	11.2	7.7

Source: Ontario Treasury analysis of personal income tax data.

Administration

The system is relatively problem-free in terms of administration. The credit form is completed by taxfilers when filing their yearly income tax return. As part of the Tax Collection Agreement, the federal government administers the system on behalf of Ontario, making payments to taxfilers eligible for a refund of Ontario tax and reducing Ontario's personal income tax entitlement accordingly. This is quite a simple system, particularly from the point of view of the taxfiler. However, the linking of the system to the federal income tax collection mechanism does preclude greater flexibility, especially in terms of more frequent benefit delivery.

II Detailed Analysis of the Impact and Effectiveness of the Ontario Tax Credit System

The delivery of relief by the Ontario Tax Credit System is examined in detail in this chapter. In particular, the distribution of credits by income, profiles of credit recipients and the influence of credits on the incidence of income taxation are reviewed.

The basic data on the performance of the system is presented in Table II-1. This table documents three notable features of the credit system over the period:

(1) the more than doubling in the dollar value of benefits.

(2) the considerable increase in the number of credit recipients and the growing participation amongst the population.

(3) the progressive decline in the number of taxfilers receiving a credit and the average credit entitlement as gross income increases.

Distribution of Ontario Tax Credits By Income, 1972-1975. — Table II-1

	1972		1973		1974		1975	
Income	No. of Credit Filers	Average Credit	No. of Credit Filers	Average Credit	No. of Credit Filers	Average Credit	No. of Credit Filers	Average Credit
($000)	(000)	($)	(000)	($)	(000)	($)	(000)	($)
Less than 5	737	102	1,021	127	1,118	161	1,173	156
5-10	947	77	936	109	816	156	750	174
10-12	300	57	344	85	348	104	322	117
12-15	225	44	312	73	395	75	439	82
15-20	102	31	175	57	200	50	273	55
20-25	14	27	43	43	18	46	31	50
Total of Credit Filers	2,329		2,842		2,898		2,995	
Total Value of Credits		180M		296M		387M		404M

Source: Ontario Treasury analysis of personal income tax data.

Note: Lack of reliable data excludes those filers above $25,000 income from the table but not from the total.

Performance of the Ontario Tax Credit System: 1972-1975

As explained in the previous chapter, the growth in the number of credit recipients and in the dollar value of benefits shown in Table II-1 reflect both changes in the credit formula and the behaviour of the economy. The interaction of these forces from 1972 to 1975 is detailed in the succeeding paragraphs.

The increase in total credit payments in 1973, relative to 1972, is primarily a result of the addition of the sales tax and pensioner credits. The introduction of those credits in 1973 increased payments by about $70 million and $45 million respectively, while the number of taxfilers receiving credits increased by 360,000—including almost 300,000 taxfilers with no occupancy cost. All brackets experienced higher average credit entitlements, but the bulk of the increase in taxfilers occurred in the lowest income group. By 1975, the value of these two credits alone had increased to close to $145 million, and 700,000 more taxfilers received a credit than would have been the case under the property tax credit alone.

The formula modifications of 1974 increased the average value of credits for low-income taxfilers by over 40 per cent, but mitigated against secondary filers and high-income taxfilers. Total costs increased by almost $70 million compared to what the 1973 formula would have yielded. The number of credit recipients increased only marginally.

By 1975, the 1974 modifications to the formula were worth $75 million in additional property tax credits. Total credit recipients in 1975 were, however, 200,000 lower than would have been the case had the formula remained unchanged from its 1973 counterpart.

The particularly large increases in the size and types of personal income tax exemptions served to considerably reduce 1974 taxable income relative to 1973 taxable income for a given gross income and, this development, when complemented by strong income growth, moved taxfilers to higher gross income classes with little or no change in taxable income. This factor, when combined with the dampening effects of the formula changes, worked to hold constant the amount of benefits received by those in the middle income range ($12,000-$20,000).

For 1975, there were no changes to the credit formula, but total payments and the number of recipients both increased.[15] The Ontario Tax Reduction introduced by the Government of Ontario served to enrich the credit system for low-income taxfilers. Specifically, the tax change ensured that where no federal tax was payable, no Ontario tax would be payable. Consequently, for 1975, any taxfiler with less than $1,395 taxable income received a full credit entitlement (i.e. with no offset). It is estimated that this enrichment was worth $7 million in increased credit payments for 1975. In addition, a relatively large increase in occupancy cost and the substantial personal income tax indexing factor for 1975 worked to increase both the number of credit recipients and the percentage of credit recipients falling within the higher income classes.

Implications of the Ontario Tax Credit System for Tax Burdens

The inverse relationship between income and credit entitlements, as shown in Table II-1, is dictated by the credit structure. It ensures that the higher the tax burden faced, the higher the credit. But, as indicated earlier, it also ensures that the higher the taxable income, the lower the credit, since taxable income indicates ability-to-pay.

The original credit formula delivered just over 80 per cent of its relief to taxfilers with less than $10,000 income in 1972. In the following years, the system continued to concen-

[15]Although average credit for 1975 for the lowest income group is shown to decline relative to 1974, this is actually a statistical aberration. Average credit in 1975 increased for both filers with occupancy cost and filers without occupancy cost. But the latter group, with their considerably lower average credit, grew by over 100,000 filers, while the former group declined by 40,000. This new mix of recipients produced an overall average credit in the lowest bracket less than that recorded for 1974. Table II-3 bears out this analysis.

trate its relief on lower income taxfilers, with taxfilers having less than $10,000 income receiving 79 per cent of relief in 1973, 80 per cent in 1974 and 78 per cent in 1975.

To best gauge the magnitude of relief provided, and to focus on the income redistributive aspects of the system, it is useful to examine the incidence impact of the credit scheme. Tables II-2 and II-3 present an indication of the success of the credit scheme, employing as an "incidence" measure the percentage of total income expended upon income taxes by an income group. Since it uses only the income tax, this measure must be considered a partial indicator of incidence. Ideally, one would wish to assess the aggregate of the property tax, sales tax and income tax burdens, but the difficulty in measuring the first for renters and the lack of up-to-date data on sales tax by income class preclude this approach.

Impact of the Ontario Tax Credit System on Average Effective Income Tax Rates for all Filers
(per cent)

Table II-2

	Before Credits				After Credits			
Income	1972	1973	1974	1975	1972	1973	1974	1975
($000)								
less than 5	1.6	1.4	1.1	0.5	0.0	—1.4	—3.1	—4.0
5-10	3.6	3.6	3.3	2.9	2.8	2.6	2.0	1.6
10-12	4.2	4.3	4.1	3.8	3.7	3.6	3.3	3.0
12-15	4.6	4.7	4.4	4.2	4.3	4.2	4.0	3.7
15-20	5.1	5.2	4.9	4.7	4.9	4.9	4.7	4.5

Source: Ontario Treasury analysis of personal income tax data.

Impact of the Ontario Tax Credit System on the Effective Income Tax Rates for Credit Recipients
(per cent)

Table II-3

	Before Credits				After Credits			
Income	1972	1973	1974	1975	1972	1973	1974	1975
($000)								
less than 5	1.3	1.2	0.6	0.2	—3.9	—4.1	—6.2	—5.9
5-10	3.5	3.5	3.2	2.7	2.5	2.1	1.1	0.3
10-12	4.2	4.3	4.1	3.7	3.7	3.5	3.1	2.6
12-15	4.5	4.6	4.5	4.2	4.2	4.1	3.9	3.5
15-20	5.1	5.1	4.6	4.3	4.9	4.8	4.3	4.0

Source: Ontario Treasury analysis of personal income tax data.

Table II-2 illustrates the impact of the tax system on Provincial tax payable for all taxfilers. The data indicates that the credit works in a progressive manner; the largest reductions in the burden of Provincial income tax accrued to the lowest income taxfilers. A negative incidence reflects a tax refund. The reduction in "after credits" incidence decreases as gross income (and consequently taxable income) increases. Table II-3 shows the reduced burden for only those taxfilers receiving credits. The reductions exceed those found in Table II-2, as would be expected. In particular, the refund for those credit recipients with less than $5,000 income is substantially larger.

A Profile of the Tax Credit System

Types of Tax Credits

The contribution of each of the three credits which comprise the Ontario Tax Credit System is shown in Table II-4.[16] The table indicates that, while the value of all three credits has shown an upward trend, it is the property tax credit which represents the bulk of payments and is the generator of most of the growth in total payouts. The impact of the change in the property tax credit formula in 1974 is readily noticeable.

Property Tax, Sales Tax and Pensioner Credits — Table II-4

	1972	1973	1974	1975
Property Tax Credit				
— value ($ million)	180	183	259	266
— no. of recipients (000)	2,329	2,483	2,327	2,290
Sales Tax Credit				
— value ($ million)	—	69	71	79
— no. of recipients (000)	—	2,829	2,869	2,913
Pensioner Credit				
— value ($ million)	—	45	57	63
— no. of recipients (000)	—	458	526	585

Source: Ontario Treasury analysis of personal income tax data.

Note: 1973, 1974 and 1975 relative values are determined by a simulation procedure which allocates to each individual first a pensioner credit (where applicable), then a sales tax credit. The remainder is the property tax credit.

Principal and Secondary Taxfilers

With the introduction of sales tax and pensioner credits in 1973, taxfilers who had no occupancy cost became eligible to file for a credit. Since then, the tax credit system has delivered relief to two distinct groups of taxfilers called "principal taxfilers" (those with occupancy cost) and "secondary taxfilers" (those with no occupancy cost). This latter group is characterized by working spouses and pensioners residing with their children. Table II-5 looks at the impact of the credit system on these two groups.

As would be expected, the number of credit recipients and the average value of credit received is considerably lower for taxfilers without occupancy cost. Table II-5 indicates a decline over the period 1973-1975 in the number of credit recipients with occupancy cost and with less than $12,000 income. The number of taxfilers in this income range claiming occupancy cost fell from 79 per cent of all occupancy cost claimants and 54 per cent of taxfilers in 1973 to 69 per cent and 50 per cent respectively in 1975. However, a compensating factor was the rapid increase in the number of taxfilers without occupancy cost receiving credits. Taxfilers receiving credits but having no occupancy cost as a percentage of all taxfilers increased from 8.5 per cent in 1973 to 16 per cent in 1975 for the under $12,000 income group. The lack of any significant changes to the credit formula in favour of these taxfilers and the fact that the average credit remains relatively stable for the bulk of the secondary recipients indicates that the increase in the number of taxfilers is due primarily to greater awareness of the program.

[16]Since the credit operates in actuality as one system, tax data do not break the system into its components. Consequently, assumptions are necessary to simulate the credits. As long as these assumptions are consistent from year to year, the simulations will produce valid comparisons even if simulation totals differ from actual.

Tax Credit Payments by Occupancy Cost Status — Table II-5

Income ($000)	1973 No. of Credit Filers (000)	1973 Average Credit ($)	1974 No. of Credit Filers (000)	1974 Average Credit ($)	1975 No. of Credit Filers (000)	1975 Average Credit ($)
Filers with Occupancy Cost						
less than 5	751	160	720	231	667	248
5-10	921	110	797	159	718	180
10-12	343	85	347	104	320	118
12-15	312	73	394	76	438	82
15-20	175	57	200	50	272	55
20-25	42	43	18	46	31	50
Total	2,557	286M	2,480	370M	2,452	386M
Filers with no Occupancy Cost						
less than 5	271	36	400	37	506	35
5-10	14	61	19	57	32	56
10-12	1	48	1	21	2	35
12-15	neg	neg	neg	neg	1	25
15-20	—	—	—	—	1	48
20-25	—	—	—	—	1	28
Total	286	11M	420	16M	543	20M

Source: Ontario Treasury analysis of personal income tax data.
Note: Lack of reliable data excludes those filers above $25,000 income from the table but not from the total.

Homeowners versus Renters

Occupancy cost is based on both property tax and rent. Homeowners are allowed to include all property tax paid while renters include 20 per cent of rent as a proxy for the property tax component of rent. Table II-6 illustrates the breakdown of credit recipients with occupancy cost into homeowners and renters, and compares certain characteristics of these taxfilers.

Tax Credits by Tenure — Table II-6

	1972	1973	1974	1975
Homeowners				
— number of credit recipients (000)	1,231	1,296	1,180	1,136
— average occupancy cost ($)	426	429	434	486
— average credit ($)	79	116	151	160
— average gross income ($)	8,431	9,610	9,784	10,540
Renters				
— number of credit recipients (000)	1,001	1,152	1,200	1,209
— average occupancy cost ($)	248	256	280	311
— average credit ($)	74	107	150	159
— average gross income ($)	6,128	6,533	6,841	7,303

Source: Ontario Treasury analysis of personal income tax data.
Note: Excludes those taxfilers who claim both property tax and rent in one year.

Table II-7 looks at occupancy cost from a different perspective, that of tax credits by occupancy cost. This table generally indicates the positive relationship between occupancy cost and credit entitlement. There is some variation in the average credit, but this is to be expected given that occupancy cost is but one variable determining credit entitlement. The table also indicates the distribution of occupancy cost, and it appears from the data that close to three-quarters of principal taxfilers have occupancy cost of less than $400. At the same time, the table also clearly shows the increase in occupancy cost over the period.

Credit Entitlement by Occupancy Cost — Table II-7

Occupancy Cost	1972		1973		1974		1975	
	No. of Claimants	Avg. Credit	No. of Claimants	Avg. Credit	No. of Claimants	Avg. Credit	No. of Claimants	Avg. Credit
	(000)	($)	(000)	($)	(000)	($)	(000)	($)
0- 100	593	70	673	107	587	139	483	152
100- 200	474	77	505	116	497	165	454	170
200- 300	457	78	492	113	486	158	444	163
300- 400	338	76	386	109	396	145	399	156
400- 500	221	79	245	106	251	134	290	142
500- 600	112	83	118	114	127	137	171	145
600- 700	54	89	60	115	60	136	90	149
700- 800	28	94	32	121	30	152	46	154
800- 900	16	100	18	125	16	160	27	167
900-1000	9	107	10	135	10	171	16	169
1000+	19	136	19	164	21	192	33	207

Source: Ontario Treasury analysis of personal income tax data.

Tax Credits and Pensioners

The tax credit system particularly benefits taxfilers aged 65 and over, especially since sales tax and pensioner credits were introduced. The pensioner credit of $110 is of course available only to taxfilers aged 65 and over. In addition, the higher income tax exemptions afforded pensioners result in higher potential sales tax credits and also reduce taxable incomes in relation to the rest of the taxfiling population. The relative pattern of benefits for those over and under 65 years of age is displayed in Table II-8.

As indicated in the table, credit recipients aged 65 and over experience a considerably higher average tax credit entitlement than do other persons, and the average credit has grown faster for pensioners. As well, while about 60 per cent of all taxfilers under age 65 received a credit in 1975, about 95 per cent of pensioner taxfilers received a tax credit in that same year. This compares favourably to 1972, when about 70 per cent of pensioner taxfilers received a tax credit.

The Dynamic Nature of Income Redistribution

Earlier, the impact of economic growth on the amount of tax relief was reviewed. It is also important to look at the dynamic aspects of income redistribution to get a complete picture of the impact of the Ontario Tax Credit System. To illustrate, Table II-9 indicates that the share of credit payments and credit recipients in the over $10,000 income bracket increased from 1974 to 1975. At face value, this would appear to be a redistribution of income in the wrong direction, an undesirable effect. However, this is not the case. The

Distribution of Tax Credits by Age — Table II-8

	1972		1973		1974		1975	
	under 65	65 and over	under 65	65 and over	under 65	65 and over	under 65	65 and over
With occupancy cost								
— number of filers (000)	1,967	362	2,162	395	2,038	442	2,002	450
— average credit ($)	72	105	91	228	116	300	121	317
— total credits ($ million)	142	38	196	90	237	133	242	143
Without occupancy cost								
— number of filers (000)	—	—	194	92	289	131	410	133
— average credit ($)	—	—	13	87	14	89	22	86
— total credits ($ million)	—	—	3	8	4	12	8	12
All filers								
— number of filers (000)	1,967	362	2,356	487	2,326	572	2,412	583
— average credit ($)	72	105	84	201	104	251	103	265
— total credits ($ million)	142	38	199	98	242	145	249	155

Source: Ontario Treasury analysis of personal income tax data.

Participation by Income Class — Table II-9

Income	Credit Recipients in Income Class as a % of all Credit Recipients	Credits Received as a % of Total Credit Payments	Taxfilers in Income Class as a % of Total Taxfilers	Credit Recipients as a % of Taxfilers
($000)	(000)	(%)	(%)	(%)
1972 less than 5	31.6	41.8	46.3	38.1
5-10	40.7	40.5	33.4	68.0
10-15	22.6	15.0	14.2	88.7
15-20	4.4	1.8	3.5	69.4
1973 less than 5	35.9	43.8	43.5	53.0
5-10	32.9	34.5	31.8	66.4
10-15	23.2	17.5	16.6	89.0
15-20	6.2	3.4	4.6	85.4
1974 less than 5	38.6	46.5	39.1	61.4
5-10	28.2	33.0	29.4	59.4
10-15	25.7	17.0	19.3	82.6
15-20	6.9	2.6	7.2	59.5
1975 less than 5	39.1	45.3	35.0	70.6
5-10	25.0	32.4	27.9	56.5
10-15	25.4	18.2	20.5	78.1
15-20	9.1	3.7	9.5	60.4

Source: Ontario Treasury analysis of personal income tax data.

result is neither surprising nor inappropriate given that the dynamics of a growing economy shift taxfilers from lower income groups to higher income groups over time. To this extent, there is a natural reduction in the number of potential credit recipients in the lower income groups. But Table II-9 also shows that, in terms of "participation" in the system, a larger share of taxfilers under $10,000 income received credits in 1975 than in 1974. Thus, the credit system in actuality increased its impact on taxfilers with less than $10,000 income.

At the same time, there was also a shift in the composition of taxfilers receiving credits in the lowest income bracket in favour of taxfilers without occupancy cost. It would appear that taxfilers reporting occupancy cost experienced faster income growth than taxfilers without occupancy cost.

In any event, with the proportion of taxfilers in the "low-income" range with occupancy cost declining over time, the share of relief to lower-income groups should be expected to fall. This result is consistent with the purpose of the system since taxfilers with no occupancy costs need less of a credit to reach a more appropriate tax burden.

It must be emphasized that Ontario's tax credit scheme redistributes income according to tax burdens faced, not simply on the basis of income levels. In order to be eligible for a tax credit, taxfilers must incur property tax, make expenditures on which sales tax is levied, or be aged. The credit system is directly linked to these variables, and, in a dynamic system, these variables alter in value from year to year. In a growing and inflationary economy, the distribution of credit payments will automatically swing away from lower income groups. The behaviour of the three important variables by income class (based on their proxy values) is shown for 1974 and 1975 in Table II-10.

Tax Affordability Indicators, 1974 and 1975 — Table II-10

Income	Share of Total of Occupancy Cost Claimed		Share of Total Basic Exemptions Claimed		Share of Taxfilers Aged 65 and Over	
($000)	1974	1975	1974	1975	1974	1975
less than 5	19.8	18.5	34.5	31.4	68.5	63.7
5-10	27.4	26.8	27.9	26.2	20.4	22.6
10-12	15.6	13.8	9.9	9.4	3.1	4.0
12-15	20.1	21.2	11.8	12.5	3.0	3.7
15-20	12.5	16.2	9.2	11.6	2.2	2.6
20-25	1.6	2.5	3.2	4.4	1.0	1.2
	100.0	100.0	100.0	100.0	100.0	100.0

Source: Ontario Treasury analysis of personal income tax data.

Note: These indicators attempt to measure on a relative basis how tax burdens shift over time. An increase in any of the factors for a particular income group indicates that group faced an increased tax burden in that year relative to the previous year.

As this table points out, all three of these variables indicate that a greater share of the tax burden was paid by the higher income groups in 1975 than in 1974. As a result, the share of credit benefits also swung more in favour of these higher income groups, a reflection of the responsiveness of the credit structure to a shifting income and tax mix.

Summary

This chapter has demonstrated the success of the Ontario Tax Credit System in delivering large amounts of relief in a progressive fashion. The system redistributes tax burdens and increases disposable income for those least able to afford taxation. Taxfilers with under $10,000 income received about four-fifths of the tax credit benefits over the

1972-75 period. The credit is linked to occupancy cost and responds directly to changes in property taxation, thus sheltering low-income persons from any sizable increase in tax burdens. Homeowners and renters receive the bulk of the relief, but other taxfilers who do not pay property tax are still eligible for a credit. Pensioners are particularly well served, receiving substantially larger shares than non-pensioner credit recipients. As the incidence table shows, the reduction in tax payable is greatest for the very low-income taxfiler and the size of the reduction decreases as income (and tax payable) increases. Finally, the system responds well over time to changing economic criteria, ensuring that relief is delivered to those who face tax burdens.

III Tax Credits and Tax Reform

This chapter examines tax credits in the broader context of tax reform.

In the 1969 Ontario Budget, Ontario presented its views on tax reform in terms of broad and general objectives.[17] These stated goals were: (1) to move to a more equitable and more elastic tax mix; (2) to coordinate the provincial and local tax structures in terms of the individual taxpayer; and, (3) to rationalize and coordinate the federal-provincial tax structure in Ontario. Just over one year later, the Government of Ontario publicly presented more specifically the proposals it wished to see guide tax reform.[18]

As indicated earlier, the federal white paper, also presented in 1969, demonstrated quite clearly that the reform process at the federal level was concerned primarily with the equity of federal taxation, with little concern for the rationalization or harmonization of the total federal, provincial and municipal tax burden on the individual. Further, the federal government had singled out the income tax as the vehicle by which the new equity would be implemented. Improvement in equity was a viable and important goal, but by concentrating exclusively on the federal tax burden, the federal government was precluding the achievement of any meaningful reform. As Ontario emphasized, "each of the [major studies on tax reform] was incomplete; they did not look at the total tax system . . . bearing upon taxpayers. In recognition of this serious flaw, Ontario advocated comprehensive reform in its own white paper . . . Unless the federal-provincial-municipal tax system is redesigned in a comprehensive and co-ordinated manner, meaningful redistribution of tax burdens cannot be achieved and the best interests of taxpayers will not be served."[19] Ontario correctly pointed out that it is the more regressive taxes, which are significant revenue generators but inflexible in structure, that represent the greatest tax burden on low-income taxfilers.

In the Province's opinion, tax credits provided an effective mechanism for achieving such "real" reform by using revenue generated from the more progressive taxes to offset the burden of the less progressive taxes. This approach was advocated by the Province in its white paper on taxation. However, the Province has to work within the confines of the Tax Collection Agreement and may unilaterally change only the rate of its personal income tax; the tax base and structure may be changed only by common consent with Ottawa. In this regard, the federal government welcomed comments and suggestions regarding the income tax structure, but retained the ultimate decision as to who should pay income tax and the relative burdens of taxpayers. There was no doubt that the federal government was sincere in its desire to redistribute tax burdens and prevent the level of taxation in Canada from becoming stifling. The federal white paper on tax reform as presented by the Hon. E. J. Benson in 1969 stated: "Canadians in the lower income tax brackets face a heavy total tax burden. In recent years sales taxes and property taxes have been increased substantially. Where changes in the income tax can provide relief, it must be given to those with lower incomes."[20] To implement this policy, the federal government

[17]Hon. Charles MacNaughton, *op. cit.*
[18]Hon. Charles MacNaughton, *Ontario Propoposals for Tax Reform in Canada* (Toronto: Department of Treasury and Economics, 1970).
[19]*Ibid.*, p. 7.
[20]Hon. E. J. Benson, *op. cit.*, p. 6.

planned to broaden the tax base, raise the tax rates and increase exemptions. Provincial analysis indicated that the federal package would lead to a considerable increase in tax revenue while yielding only modest improvements in equity. As well, the federal government was making no attempt to co-ordinate income taxation with other types of taxation.

Emphasizing that selective measures would be the most effective means of providing relief to those groups who need it most, the Province recommended that, rather than increase exemptions, the federal government should provide:

- a low income allowance (an additional exemption for low-income taxpayers); and,
- refundable tax credits to offset the provincial-municipal burden on those people who do not earn enough to pay income taxes.[21]

In implementing its tax reform policy, the federal government rejected the provincial concept of tax credits in favour of its proposed package—a revamped rate schedule, a slightly broadened tax base and higher exemptions. Although this package is analyzed in considerable detail elsewhere, it is sufficient to say that the reform package was not particularly successful in achieving actual reform.[22] And, in fact, it has been necessary for the federal government to introduce massive increases in exemptions in the period since reform in order to control the revenue growth of the tax. As documented, these increases have succeeded in reducing income tax payable. But this reduction has been achieved without any significant increase in equity and at the expense of considerable Provincial revenue.

Ontario continues to take issue with the federal government as to the appropriate actions necessary to achieve meaningful tax reform. Large increases in exemptions do nothing for individuals already facing a zero income tax burden. Conversely, for those individuals with the incomes to take advantage of such provisions, they represent considerable tax savings. The introduction and subsequent expansion of the reduction in basic federal tax provides for some offset to these problems as it delivers reductions in a somewhat progressive fashion. As well, the recently announced federal tax credit of $50 per child is a further improvement to the current structure—because the value of this reduction is generally independent of income. However, the credit is not refundable, and so its advantage to low-income persons is limited. If anything, the introduction of the federal credit is a product of the shortcomings in the original reforms to the Income Tax Act (Canada).

By developing the Ontario tax credit system, Ontario attempted to bring together property tax, sales tax and income tax and determine the ultimate burden of these taxes according to ability-to-pay. As a necessary part of this policy, Ontario went beyond the concept of removing income tax liability and refunded tax dollars where credits exceed income tax liabilities.

This study has documented the success of this program in redistributing tax burdens, and has illustrated that real progress has been made in improving the overall tax burden for low-income Ontario taxfilers.

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[21]Hon. Charles MacNaughton, *op. cit.*, p. 16.

[22]See Ontario Tax Studies 13, *The Equity and Revenue Effects in Ontario of Personal Income Tax Reform: 1972-75* (Ministry of Treasury, Economics and Intergovernmental Affairs, Toronto, 1977).